

## Submission on draft Carbon Abatement Contract

This submission is by the Aboriginal Carbon Fund. Aboriginal Carbon Fund is a national not-for-profit company helping to build wealth for traditional owners through the ethical trade of carbon credits. The Aboriginal Carbon Fund was established in 2010.

[aboriginalcarbonfund.com.au](http://aboriginalcarbonfund.com.au)

### Land sector abatement

We work in the land sector.

The first thing to say is there is a clear **need** for land sector abatement to reach the 5 per cent reduction target by 2020. Climate Works Australia has found that meeting the target will require all of the available energy efficiency gains plus half the achievable land sector abatement.

The second is that land sector projects take a **long time**. To start a savanna project takes a lot of wrangling on the ground, consultation on governance arrangements and careful planning of broad scale fire management. For planting projects you can also add high costs for ripping ground, buying seedlings and heavy doses of labour.

The third is that land sector projects are holistic projects which deliver a range of **multiple benefits**. Continued successful savanna projects will deliver social, environmental and cultural benefits such as healthy country, biodiversity benefits and jobs where opportunities are few.

The fourth is that land sector projects require **ongoing management** over time to maintain benefits. An energy efficiency project might have ongoing benefits from a one off upgrade, but the broader environmental and employment benefits of a savanna burning project will be reversed if the project stops.

What the ERF contracting proposal does is focus the selection of projects on the cost of carbon abatement only. The proposal seeks to minimise the risk to Government but in a way that pushes risk back on to the producers of carbon abatement.

The focus on reducing the risks of delivering lowest cost abatement comes at the expense of broader considerations, like those associated with land sector projects. This process might scoop up all the easy projects in the first years, but what kind of projects will achieve abatement after that? We need to be incubating a pipeline of future abatement to achieve our targets – including the land sector. If the challenges for land sector abatement are not addressed, we may not get any from that sector.

## Risk

Any carbon project is about managing risk against possible returns. When looking at the proposed process overall, the draft contract manages the risk for the Government much more than is the case for project owners. It's out of balance. The following table shows elements of the contract which tend to reduce risk for the parties:

<i>Risk managed for Government</i>	<i>Risk managed for seller</i>
Pre-qualification performs due diligence on potential projects	5 year forward contract provides certainty of sales for that period
Government receives marginal cost benefit of blind bidding	Delivery obligation not linked to any project
All successful bids become contracts for delivery without any negotiation	
Benchmark (maximum) bid price and contract prices not published	
No obligation to accept advanced delivery	
Delivery obligation not linked to any project	
If there is a natural disaster, projects must still 'make good'	
Termination for misleading conduct	
Contracts capped at \$2.5 billion	

Ultimately, carbon producers would like to price risk into their price, but the nature of the blind auction will tend to push prices down and make this very difficult.

Some of the items included in the table warrant further comment.

## Pre-qualification

The pre-qualification stage attempts to isolate price as the determining factor in the blind auctions. Pre-qualification checks are forecast to include any record of delivery or failure, commercial readiness of practice and capacity of the project proponent.

Aboriginal ventures commonly establish separate companies, or **special purpose vehicles**, for commercial projects to manage the risk to landholding bodies and establish clear governance of the project and any benefits. Any new company will have difficulty meeting criteria such as commercial readiness. Factors that could assist Aboriginal carbon projects to pass pre-qualification is looking at co-funding or co-contribution towards the project and record of contract delivery.

One way of assisting new entrants more generally is allowing anyone to bid issued credits into the auctions without any prequalification. If the credits already exist, there would not be any risk of non-delivery and any pre-qualification checks would be redundant.

We also note that the Government may terminate a contract for materially misleading conduct even though the Government will be running a pre-qualification process.

## Contract length

A major problem with the proposed 5 year contract is that contracts cannot be renewed and projects can only receive **one contract**. For any project with a lifespan over 5 years, this means the business case cannot be supported by an ERF contract alone. Sequestration projects often have payback times which may be 15-20 years before they are cashflow positive. This is why Reputex says the 5 year contract proposal will make the land sector “unfinanceable”.

It may be possible to use an ERF contract as part of the puzzle in putting together a project, but this may be more difficult under proposed rules which introduce a type of financial additionality test related to funding under other government programs. Sequestration projects are likely to need complementary reasons for proceeding in addition to an ERF contract.

The 5 year limitation will also hurt emissions reduction land sector projects. For example, many current approved savanna burning projects have been years in the making, a prospect that would be less likely to happen in future if the payback period is capped at 5 years.

## Force majeure

In general, we support firm delivery under the ERF to support the integrity of the scheme. However, the proposal that force majeure (or act of god) will not be triggered by **natural disturbance** is alarming. Again, the contrast with industrial or energy efficiency projects is stark – these kind of projects are much less likely to suffer a natural disaster.

For example, if a savanna project suffered a horrendous fire season, with many late season fires, this might reduce or eliminate any reductions for that year. As the proposed contract stands, this would mean the project would not only lose income for that year, but suffer the double loss of having to make good on the secondary market (such as one might exist). That is a big risk for a project to accept, and one which ought to be priced accordingly. There is a good case for force majeure to apply to natural disturbances.

## Reducing risk

There are a number of ways risks can be reduced for sellers under ERF contracts.

The first, noted above, is allowing anyone to bid existing credits into the blind auctions. This would create a **spot market** for unsold credits. This could allow projects to manage risk by underbidding in their contract and still benefit from excess credits produced. It could also allow projects to avoid the

forward contract and the risks it entails and leave open the option of selling in the voluntary market or in the ERF blind auctions.

Another way is allowing **excess credits** from contracted projects to be sold as of right at the contract price or current average auction price at the end of the contract.

Providing some **flexibility in the delivery** schedule of the contract would also be supported. For example, the contract could be for a level of abatement plus or minus 10 per cent, at the seller's discretion.

Another option that could be considered is the use of **international units** to make good for a natural disturbance or capped at say 10 per cent if used for any reason. For comparison, the proposed carbon price linkage to the EU Emissions Trading System capped use of Certified Emissions Reductions at 12.5 per cent. Some care needs to be exercised if international units are allowed into ERF processes in some form as scheme integrity will suffer if compliance is flooded with international units with lower compliance standards.

## Support for livelihoods on Indigenous land

Carbon farming provides an opportunity for Indigenous Australians to deliver an environmental benefit to the nation and an economic opportunity for themselves. But this opportunity will only be taken and benefits enjoyed if the settings are right.

There are risks with some of the above proposals, but the intent is to bring some balance to the level of risk worn by the Government and by sellers, which may increase the likelihood of participation. Just to make an ERF proposal is no small undertaking for a land sector project which may cost tens of thousands of investment dollars in business case development, consultation and planning. If there is too much uncertainty and risk on the benefit side, proposals are unlikely to come forward.

Up to now, Indigenous participation in savanna projects has not happened by chance, but is the result of a decade of careful work by traditional owners and government together. Continued successful savanna projects will deliver healthy country, biodiversity benefits, weed reduction, landscape linkages, jobs on country, business engagement and happy rangers. Much more than lowest cost abatement.

We strongly encourage the Government to provide fairness and flexibility in the ERF process that will support Indigenous carbon projects and pathways into jobs rather than welfare in places where alternative development opportunities are few.

## Suggested changes to draft ERF contract process

1. Provide flexibility for special purpose vehicles to meet pre-qualification requirements
2. Create a spot market by allowing existing credits to bid into auctions (without any pre-qualification)
3. Remove limit on number of contracts
4. Consider force majeure to be triggered by natural disturbances
5. Consider sale of excess credits under contracts at contract price or current average auction price
6. Consider a plus or minus 10 per cent tolerance on contract delivery
7. Consider use of international credits for natural disturbance or capped at 10 per cent of contract delivery for any reason